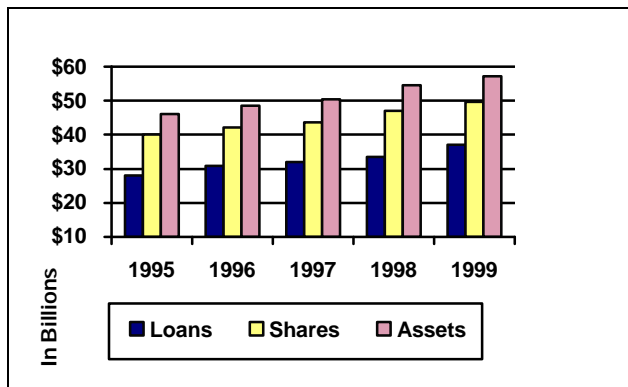


## Introduction

This report summarizes financial trends for the 1,610 federally-insured credit unions located in Region II (Capital). The Capital Region supervises credit unions in the District of Columbia, Maryland, New Jersey, Pennsylvania, Delaware, and Virginia. At year end, the region's credit unions account for \$57.2 billion in assets, \$49.7 in shares, and \$37.1 billion in loans.



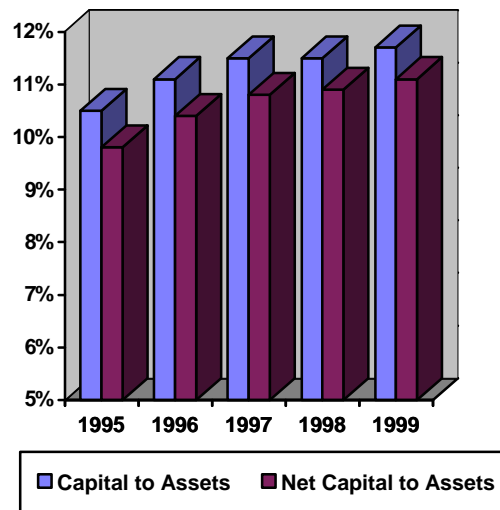
## **Region II Financial Highlights**

- ◆ Assets increased 5.0 percent from \$54.4 billion to \$57.2 billion.
- ◆ Loans increased 10.7 percent to \$37.1 billion. Loans equal 64.8 percent of assets and 74.8 percent of shares.
- ◆ Shares now exceed \$49.6 billion, an increase of 5.2 percent for the year.
- ◆ Total capital gained 6.6 percent to almost \$6.7 billion, representing 11.7 percent of total assets.
- ◆ Loan delinquency declined to 0.8 percent of total loans after being at 0.9 percent last year and 1.0 percent for three previous consecutive years.

- ◆ Net charge offs were 0.6 percent of average loans, down from 0.7 percent in 1998.
- ◆ The Return on Average Assets ratio increased from 0.9 percent to 1.0 in 1999.

## Capital

The graph below presents the region's capital and net capital ratios for the last five years. The December 1999 capital ratio was 11.7 percent of assets and the net capital ratio was 11.1 percent. At year-end 1999, all federally insured credit unions nationally had a capital ratio of 11.6 and a net capital ratio of 11.0.



Credit unions are preparing to comply with the Prompt Corrective Action regulation. As of December 31, 1998, Region II had 144 credit unions with net capital ratios of less than 7.0 percent. As of December 31, 1999, there were only 116. Fifty-five percent (64) of these credit unions were considered to be adequately capitalized with net capital of, at least, 6 percent. Only 17 credit unions had net capital ratios

of less than 4 percent. The distribution is shown below.

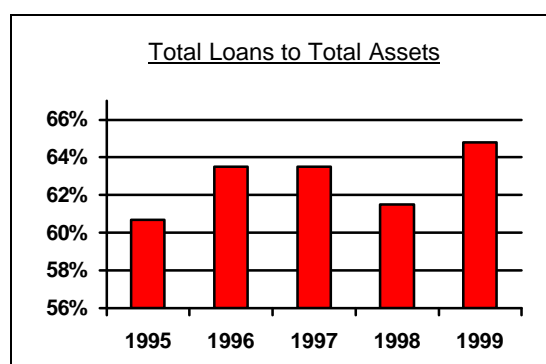
**Distribution of Credit Unions by Net Capital  
as of December 31, 1999**

Net Capital Ratio	No. of Cus	% of Total.
>7%	1494	92.3%
6-7%	64	4.0%
4-6%	35	2.7%
2-4%	7	0.4%
<2%	10	.6%

## Lending

Total loans in Region II credit unions increased by 10.7 percent in 1999 and ended the year over \$37 billion.

The ratio of total loans to total assets increased to 64.8 percent after declining to 61.5 percent in 1998. The graph below depicts this trend.



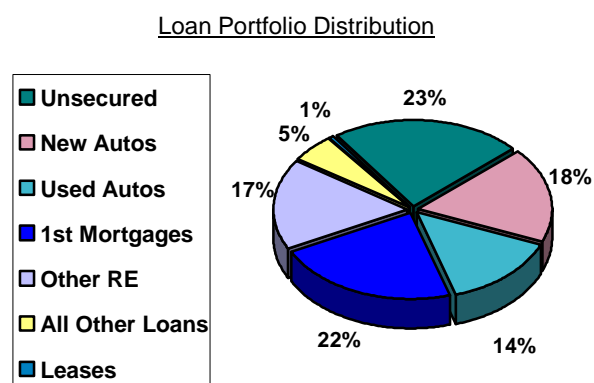
Real estate lending surpassed \$14.5 billion and accounts for 39 percent of the total Region II credit unions' loan portfolio. This is a 2.5 percent increase from December 1998.

Fixed-rate, first mortgage loans increased 31.0 percent in 1999, compared to the rate of increase in federally insured credit unions nationally of 17.9 percent.

Other fixed-rate real estate loans also grew more rapidly in 1999, increasing 12.1 percent compared to 7.3 percent in 1998. Fixed-rate mortgage loans account for 73.5 percent of all mortgage loans in Region II credit unions, compared to 70.8 percent in December 1998. Fixed-rate real estate loans equal 28.7 percent of total loans in Region II as of December 31, 1999. The increasing interest rate and liquidity risks these loans present are of concern and will be addressed through additional asset/liability management training and analysis during 2000.

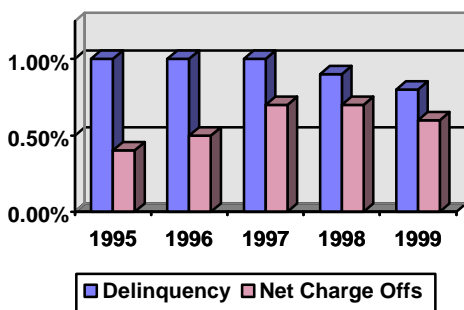
Automobile loans grew by 8.0 percent in 1999. Automobile lending continued to shift from new to used auto loans. While used car loans increased 15.4 percent during the year, new car loans increased only 2.7 percent. Used auto loans equaled 44.6 percent of total automobile loans.

The chart below illustrates the distribution of Region II credit unions' loans, by type, within the total portfolio as of December 31, 1999:



## **Delinquency & Net Charge Off Trends**

The region's credit unions continue to effectively manage the risks associated with lending. The 1999 delinquency ratio declined to .08 percent and the net charge-off to average assets ratio, declined to .06 percent, after having been 0.7 percent for two years. The following graph illustrates these trends.



#### Credit Card Delinquency

Delinquent credit card loans account for 14.3 percent of total delinquency, but credit card loans equal only 10.6 percent of total loans in Region II credit unions.

Regionally, net credit card loan losses in 1999 were 27.2 percent of total net charged-off loans, compared to 28.1 percent in 1998. Nationally, net credit card loan losses were 29.3 percent in 1999.



#### Bankruptcies

Over 46.4 percent of the 1999 Region II loan losses were the result of member bankruptcies, compared to 51.9 percent in 1998. Region II credit unions saw a 12.5 percent decrease in the amount of loans

outstanding subject to bankruptcy at the end of 1999, while nationally the amount of bankruptcy related loans increased 1.3 percent during 1999.

The number of Region II members filing for bankruptcy declined for the first year since data has been collected. The number of members filing bankruptcy decreased 15.3 percent in 1999. The number of bankruptcy filings for the past five years are presented in the following table.

#### Five Year Bankruptcy Filings

<u>Year</u>	<u>National</u>	<u>Regional</u>
1995	164,502	24,724
1996	202,611	28,475
1997	253,579	36,503
1998	243,953	38,035
1999	214,700	32,277

#### Investments

Due to the new requirement for credit unions to report some investments as cash equivalents in accordance with GAAP, investment data can not easily be compared. Many credit unions invest funds in money market, or daily accounts with corporate credit unions, which are now considered cash equivalent accounts and are reported as cash. Therefore, cash and investments from prior years are being combined for analysis. The following table provides the combined data:

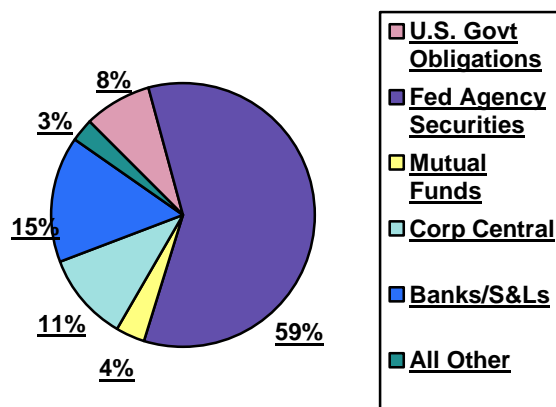
	<u>Region II</u>		
	<u>Cash</u>	<u>Invest.</u>	<u>Total</u>
1996	1,125,939,791	15,068,065,274	16,194,005,065
1997	1,150,610,691	15,515,128,891	16,665,739,582
1998	1,296,559,893	17,743,402,188	19,039,962,081
1999	4,705,860,302	13,507,897,279	18,213,757,581

Combined cash and investments declined by 4.3 percent in 1999. Investments, considered alone, declined by 23.9

percent for Region II and 17.2 percent, nationally.

Investment distribution by type is shown below:

Investment Portfolio Distribution

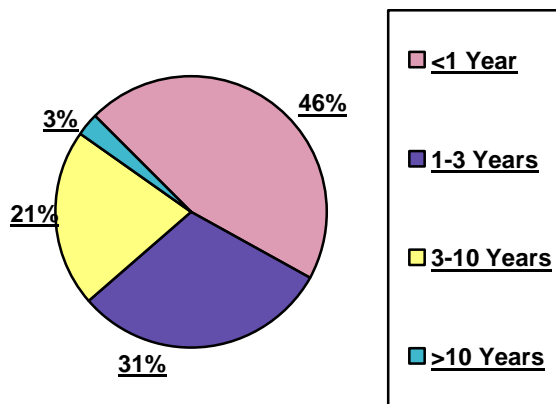


Investments with maturities in excess of 3 years in Region II credit unions grew 13.4 percent, compared to the national increase of 24.1 percent.

More than 58.5 percent of the investments with maturities in excess of 3 years are classified as available for sale. The graph in the next column shows the maturity distribution of the investment portfolio as of December 31, 1999.



Investment Maturity Distribution



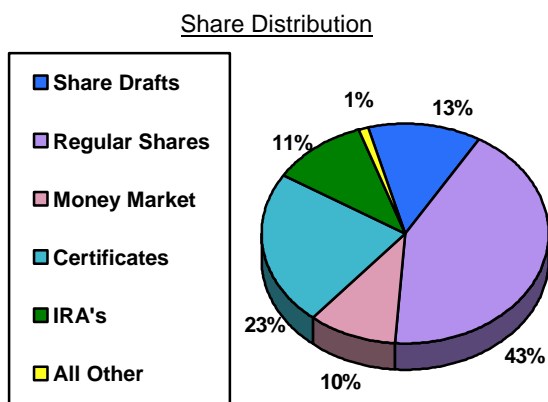
The total of investments with maturities in excess of 3 years, (excluding NCUSIF capitalization deposits), plus fixed-rate real estate loans are approximately 23.77 percent of assets, up from 20.7 percent of assets as of December 31, 1998. These assets appear to be subject to significant interest rate risk in a rising interest rate environment. These trends reinforce the need for an extensive asset/liability management (ALM) review in more credit unions and the need to train examiners adequately to recognize problems with ALM.

Region II credit unions reported unrealized losses on available for sale investments of \$106.8 million as of December 31, 1999. Whereas, the December 1998 reports showed gains on available for sale investments of \$17.6 million.

## Savings

Total shares grew 5.2 percent in 1999, and now total \$49.6 billion. Money market shares continued to increase at a more rapid pace than all other type of member shares accounts, up 14.4 percent in 1999. Share draft accounts increased 5.7

percent. Share certificate accounts increased by 4.9 percent. Other member account types grew modestly. Non-member accounts grew 16.8 percent. Only 11.4 percent of the non-member shares are in low income credit unions. The following graph shows the share distribution of Region II credit unions at December 31, 1999 by type:



### Income Trends

Region II credit unions generated solid earnings for 1999, achieving a return on average assets of 1.0 percent. Gross income rose 4.5 percent to \$4.4 billion. Operating expenses, without Provision for Loan Losses expense (PLL), increased 10.0 percent to nearly \$1.8 billion, and the cost of funds rose nearly 1.0 percent to \$1.88 billion.

Net income increased to \$545 million or 10.5 percent, due to the smaller increase in the cost of funds and lower PLL expense.

Fee income increased 12.8 percent in Region II during 1999, compared to 15.8 percent in 1998.

Total non-interest income in Region II credit unions increased 10.6 percent,

compared to a 12.0 percent increase in all credit unions.

The earnings ratio trends for Region II credit unions over the past four years are presented in the following table:<sup>1</sup>

*	1996	1997	1998	1999
<b>Gross Income</b>	8.2	8.2	8.1	7.9
<b>Cost of Funds</b>	3.6	3.7	3.5	3.4
<b>Net Margin</b>	4.6	4.5	4.5	4.6
<b>Operating Expenses</b>	3.0	3.0	3.1	3.2
<b>Provision for Loan Loss Expense</b>	0.4	0.5	0.5	0.4
<b>Return on Average Assets</b>	1.2	1.0	0.9	1.0

One hundred and sixty-seven federally-insured credit unions reported an operating loss after reserve transfers at year-end 1999. Fifty-seven of these credit unions reported operating losses for the second year and 12 for the third year in a row.

This number increased by 7 over those credit unions reporting operating losses in 1998.

<sup>1</sup> All ratios are calculated as a percentage of average assets.

## Problem Credit Unions

Key trends indicate Region II federally - insured credit unions are financially sound. However, the number of problem credit unions (CAMEL code 4/5) as of December 31, 1999, increased to 59 federally insured credit unions with shares of \$398.5 million. As of December 1998 there were 54 problem credit unions with shares of \$424.8 million. Although the number of troubled credit unions increased, the asset size decreased. This number is still better than December 1997 when the number of problem federally-insured credit unions was 70 and 1996 when there were 65 problem credit unions.

Three credit unions with assets in excess of \$25 million entered the Camel "4" rating during the year. Two of the six Camel "4" credit unions with assets in excess of \$25 million as of December 31, 1999, were upgraded in January 2000. Aggressive supervision is being

provided to these credit unions and progress is being achieved. Supervision of long standing Camel "3" credit unions is also being increased.

At the beginning of 1999, Region II had 4 credit unions operating under special assistance provided for in Section 208 of the Federal Credit Union Act (Act). One credit union was able to completely amortize the assistance during 1999. One assisted credit union was merged and another was liquidated with a purchase and assumption agreement. Only one credit union had 208 assistance as of December 31, 1999 and it continues to be supervised under the Act's conservatorship provision.

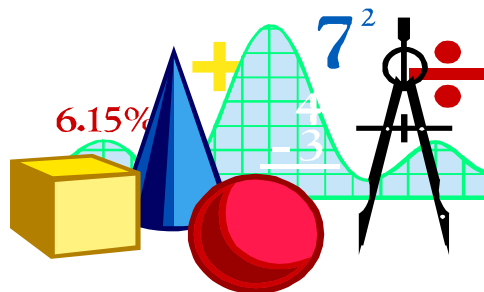
As of December 31, 1999, we had seven credit unions under supervision of our Special Actions staff.

## CREDIT UNIONS WITH ASSETS \$5 MILLION OR LESS

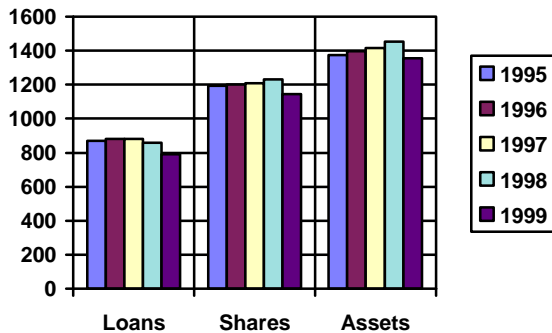
Region II has 833 federally insured (FCU and FISCUS) credit unions with assets of \$5 million or less as of December 31, 1999, compared to 914 as of December 1998. This number is 51.7 percent of the Region's credit unions. However, the total assets of this group is only 2.4 percent of the Region's total assets. Assets of these credit unions increased 3.3 percent compared 5.0 percent increase in all Region II credit unions.

During 1999, sixty-four small credit unions merged, four liquidated, and

thirteen now exceed \$5 million in assets.



As indicated in the following chart, the aggregate shares, loans, and assets for these credit unions declined in 1999 because the number of small credit union declined.

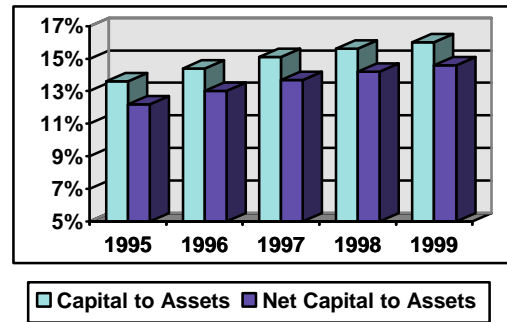


Of these smaller credit unions, 298 (35.8 percent) reported decreases in assets with 33 of them shrinking by more than 15 percent since December 31, 1998. Conversely, sixty-nine credit unions, with assets under \$5 million, grew more than 15 percent in 1999. Three credit unions showed increases in excess of 100 percent.

Of credit unions with asset of less than \$5 million, 95.3 percent were rated a CAMEL "3" or better. Of those credit unions with decreasing assets, 20 had CAMEL ratings of "4" leaving 93.3 percent rated CAMEL "3" or better.

## Capital

The following graph presents the capital and net capital to assets trends for credit unions with assets \$5 million and less. Capital and net capital ratios are higher for these credit unions than those of all Region II credit unions. The capital ratio for small credit unions increased during 1999 to 16.0 percent, from 15.6 percent as of December 31, 1998. Net capital also increased from 14.2 percent to 14.6 percent of assets.



As of December 31, 1999, only 6.8 percent (57 credit unions) with assets under \$5 million were found to have net worth ratios of less than 7.0 percent. The following table show the distribution of these credit unions by net capital ratios.

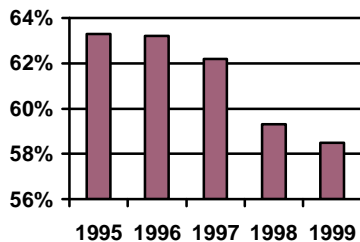
**Distribution of Small Credit Unions by Net Worth as of December 31, 1999**

Net Worth Ratio	No. of Cus	% of Total
>7%	775	93.0%
6-7%	25	3.0%
4-6%	19	2.3%
2-4%	5	0.6%
<2%	9	1.08%

## Lending

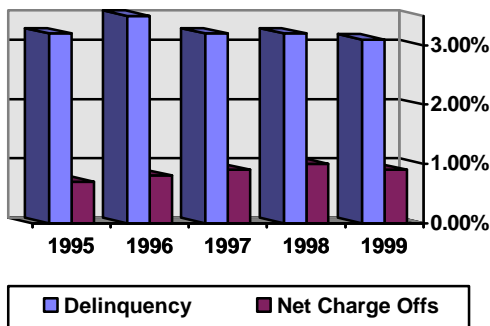
Total loans have decreased both in total dollars outstanding and in relationship to total assets in these smaller credit unions. As shown on page 2, all Region II credit unions experienced increased lending, rising to 64.8 percent of assets. But in small credit unions the ratio of loans to assets dropped from 59.3 percent to 58.5 percent. The following chart shows the trends in total loans to assets.

Total Loans to Total Assets



Delinquency and loan losses in credit unions with assets of \$5 million and less are higher than in the combined ratios for the Region. Delinquent loans to total loans in these credit unions declined slightly. This compares to 0.8 percent in all credit unions. Small credit unions losses were 0.9 percent of average loans, while all credit union losses were 0.8 percent for 1999.

The following chart depicts the delinquency and loan loss trends in smaller credit unions.

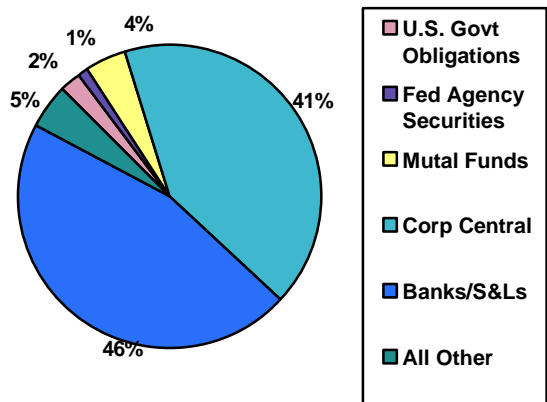


## Investments

Investments and cash in smaller credit unions increased by 5.9 percent in 1999, compared to 10.3 percent in 1998. Nearly 32 percent of the total of cash and investments was reported as

cash or cash equivalents as of December 31, 1999. The distribution of investments in these credit unions is reflected in the following chart.

Investment Portfolio Distribution

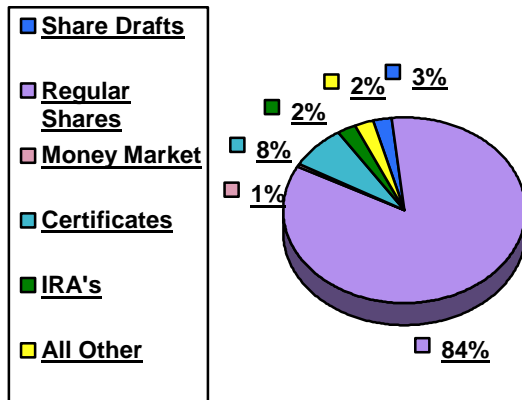


Liquidity in smaller credit unions, as a whole, is not a concern. Nearly 88.3 percent of all surplus funds are in cash, cash equivalents, or investments with maturities of less than one year.

## Savings

Total shares in small credit unions grew 3.0 percent in 1999 compared to the 5.2 percent growth in all Region II credit unions. The amount deposited in share draft accounts increased 11.9 percent. The following chart shows the share distribution in credit unions with assets \$5 million and less as of December 31, 1999.

### Share Distribution



### Income Trends

Region II credit unions with assets of \$5 million or less generated a return on average assets of .7 percent, which is considerably less than the 1.0 percent earned by all of the Region's credit unions. Gross income of these credit unions declined by 30 basis points to 7.9 percent, but cost of funds only decreased by 10 basis points to 3.0 percent, thus causing a shrinking net margin. Operating expenses remained stable at 3.7 percent. The earnings ratio trends for small credit unions in Region II are shown in the following table:

### Earnings Trends in Credit Unions with Assets <\$5 Million

*	1996	1997	1998	1999
Gross Income	8.4	8.3	8.2	7.9
Cost of Funds	3.2	3.2	3.1	3.0
Net Margin	5.2	5.2	5.1	4.9
Operating Expenses	3.6	3.7	3.7	3.7
Provision for Loan Loss Expense	0.6	0.6	0.5	0.5
Return on Average Assets	1.0	.9	0.9	0.7

\* All ratios are calculated as a percentage of average assets.

### **Small Credit Union Program (SCUP)**

Region II's small credit union program has been enhanced and expanded to provide more assistance to small credit unions. Region II has 833 credit union eligible for participation in SCUP. However, we have identified 46 credit unions which will receive assistance from the Economic Development Specialists.

In addition, each SE group appointed a Credit Union Resource Examiner (CURE). The CURE is a group expert on issues related to small, low income designated, and newly chartered credit unions.

We expect the additional assistance will help officials improve the financial and operational condition of these specially designated credit unions.

### **Y2K**

1999 was a very busy and challenging year for Region II staff as we worked to ready credit unions for the century date change.

Field staff made 3,288 credit union contacts and spent 29,627 hours evaluating and assisting credit unions prepare for the year-end rollover. This does not capture the countless hours spent by management and regional office staff in developing policy, reviewing examiner reports, providing guidance to field staff, and preparing management reports for internal and external use.

These efforts, along with those of the state supervisory authorities, and the credit union industry were effective. No Year 2000 problems occurred.

### **ELECTRONIC CREDIT UNION SERVICES**

Region II piloted an electronic credit union services examination program in the fourth quarter of 1999. The examination program was developed in response to the recognition that a rapidly growing number of credit unions are offering some type of electronic credit union service which is exposing new types of risk.

The electronic services of 22 federal credit union were examined in the pilot program. The examinations revealed no material weaknesses in the implementation of electronic financial services.

As part of the pilot program, Region II asked its staff to determine the types of services being offered and planned by credit unions. The following chart shows the number of Region II federal credit unions offering some type of direct or internet-based member service at the time of the examination survey. The number of federal credit unions planning to implement some type of service in the year 2000 are also included.

Type	Info. Only	E-Mail & Applications	Transactions	Dial Up
# of FCUs Using	114	53	122	39
# of FCU with Plans	61	31	102	UNK

## INSURANCE ISSUES

### Charter Amendments

After the new chartering and field of membership policy became effective, requests for charter amendments increased dramatically.

In 1999, a total of 3,173 amendments were approved, 101 were denied, and 489 were deferred, pending additional information. In 1998, only 96 charter amendments were approved.

Merger activity also dramatically increased with the implementation of the field of membership policy. The number of mergers increased 153 percent in 1999, with 76 approved in 1999 compared to 30 in 1998.

Because of the moratorium on charter amendments in 1998, a number of credit unions sought authority to convert to community type field's of membership. Six conversions were approved during 1999 and as of December 31, 1999, 11 requests for conversion were pending. In addition, 5 community credit unions had requests for charter expansion pending approval as of December 31, 1999.

All chartering activity approved in 1999 is shown in the chart in the next column:

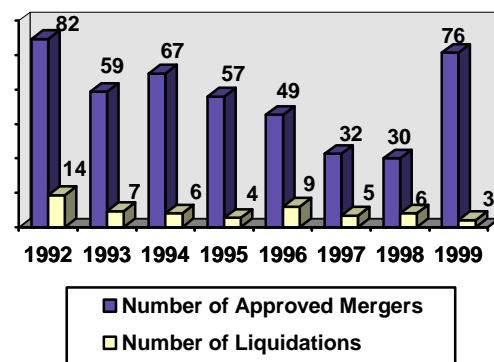
### # Approved

Charter Amendments	3,173
New Federal Charters	0
New Federally-insured State Charters	1
Mergers - unassisted	73
Mergers - assisted	3
Purchase & Assumption	2
Voluntary Liquidations	1
Involuntary Liquidations	1
Conversion from State to Federal Charter	0
Conversion from Federal to State Charter	1
Conversion to a Community Charter	6

The Division of Insurance had six new charter requests pending as of December 31, 1999.

### Mergers

Mergers increased in 1999, after falling four consecutive years. The number of mergers increased from 30 in 1998 to 76 in 1999 as shown in the following graph:



### Charter Activity for 1999

## **Conclusion**

Region II credit unions continued to exhibit the same positive financial and operational trends noted on a national level for the year ended December 31, 1999. However, the rising interest rates cast a shadow on future results due to the large percentage of fixed-rate assets in credit union portfolios. Regional staff will emphasize the importance of managing the balance sheet risk through effective asset/liability management.